

FILED

FEB 15 1996

KEENAN G. CASADY, Clerk
U.S. BANKRUPTCY COURT-SANTA ROSA

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

In re

GERALD ARMSTRONG,

No. 95-10911

Debtor.

CHURCH OF SCIENTOLOGY
INTERNATIONAL,

Plaintiff,

v.

A.P. No. 95-1164

GERALD ARMSTRONG,

Defendant.

Memorandum of Decision

I. Introduction

Debtor and defendant Gerald Armstrong is a former member and official of plaintiff Church of Scientology. The two have been at odds with each other for many years, with Armstrong on a crusade to discredit Scientology and Scientology bent on discrediting Armstrong in return.

In 1986, the parties settled a state court lawsuit in which Armstrong claimed damages for harassment by Scientology. Pursuant to the terms of the settlement, Armstrong received \$800,000.00. In return, he agreed to cease his activities against Scientology. The settlement contained a liquidated damages provision calling for \$50,000.00 in damages for each breach by Armstrong.

In the early 1990's, Armstrong began to violate the terms of the settlement by voluntarily resuming his crusade against Scientology. Scientology commenced a lawsuit to enforce the agreement, and has obtained a judgment from the state court in the

1 amount of \$300,000.00 in liquidated damages and a permanent
2 injunction prohibiting Armstrong from continuing his activities
3 against Scientology.

4 By this adversary proceeding, Scientology seeks a
5 determination that its \$300,000.00 liquidated damages claim is
6 nondischargeable and that Armstrong's obligation under the
7 settlement to refrain from acting against Scientology is
8 nondischargeable and continues to be enforceable after Armstrong's
9 Chapter 7 bankruptcy, which Armstrong filed on April 19, 1995.
10 Scientology also seeks to deny Armstrong's discharge on the grounds
11 that he has failed to explain the dissipation of his assets and
12 failed to schedule an interest in a corporation wholly owned by
13 him.

14 II. Objection to Discharge

15 Scientology argues that Armstrong should not be granted a
16 discharge because he has failed to explain the disposition of the
17 settlement proceeds and because he failed to schedule as an asset
18 an interest in the Gerald Armstrong Corporation. Scientology has
19 not met its burden of proof as to either ground.

20 Given the 10 years between the payment of the settlement and
21 the bankruptcy, as well as Armstrong's mental state as evidenced by
22 his testimony, it is not surprising in the least that he has none
23 of the settlement proceeds left, nor is its dissipation any great
24 mystery. The fact he has nothing left is not a basis for denial of
25 his discharge.

26 The argument concerning Armstrong's failure to schedule as an
asset his interest in the Gerald Armstrong Corporation is equally
meritless for several reasons. First, despite Armstrong's

1 testimony in 1993 that he valued the corporation at \$1 billion, it
2 is clear that the stock is worthless to anyone other than him.
3 Second, there can have been no intent to conceal it because
4 Scientology knew all about it. Third, the existence of the
5 corporation was in fact scheduled, albeit in the wrong place.
6 Fourth, Armstrong voluntarily brought up his interest in the
7 corporation at his meeting of creditors without any suggestion on
8 anyone's part that he had omitted it.

9 III. Dischargeability of Liquidated Damages for Prepetition Conduct

10 Scientology did not address the issue of dischargeability of
11 the liquidated damages in its evidence or its brief, although it
12 did ask in closing argument that these damages be declared
13 nondischargeable along with associated attorneys' fees. The court
14 sees no basis for this claim.

15 Damages for breach of contract, even when the contract was
16 intentionally breached, are fully dischargeable. In re Risco, 978
17 F.2d 1151 (9th Cir.1992). The term "liquidated damages" is itself
18 a contract term. Scientology did not establish that anything
19 Armstrong did was inherently wrongful or tortious, aside from
20 breaching his agreement not to do them. In order for a breach of
21 contract to be nondischargeable under section 523(a)(6) of the
22 Code, it must be accompanied by malicious and willful tortious
23 conduct. Id. at 1154. No such conduct has been shown in this
24 case.

25 IV. Dischargeability of Permanent Injunction

26 While a literal reading of section 101(5)(B) of the Bankruptcy
Code seems to indicate that the right to seek injunctive relief to

1 enforce the settlement is dischargeable because breach gives rise
2 to a right to liquidated damages, it is clear from the subsequent
3 acts of the state court that liquidated damages are not
4 Scientology's exclusive remedy for breach. The state court has
5 issued a permanent injunction, and it is clear from case law that
6 the right to such injunctive relief survives bankruptcy. In re
7 Udell, 18 F.3d 403 (7th Cir.1994); In re Irizarry, 171 B.R. 874
8 (9th Cir.BAP 1994).

9 V. Dischargeability of Sanctions for Violation of Permanent 10 Injunction

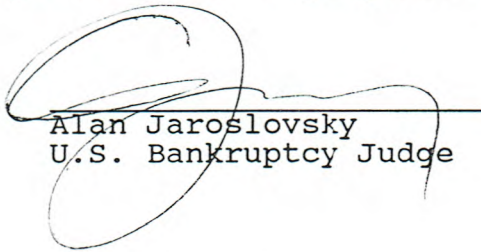
11 It does not appear that the state court has up to this point
12 issued and monetary sanctions for violation of its injunction. Any
13 such monetary sanctions are a lawful exercise of the court's
14 contempt powers, and would be nondischargeable. See In re Allison,
15 176 B.R. 60, 64 (Bkrtcy.S.D.Fla.1994), and cases therein cited.
16 While Scientology may not at this late date go back and seek to
17 turn liquidated damages to contempt sanctions, any postpetition
18 violation of the permanent injunction may be enforced by the state
19 court pursuant to its contempt powers without violating the
20 bankruptcy discharge.

20 VI. Conclusion

21 Armstrong is entitled to a discharge. Liquidated damages for
22 his prepetition conduct are dischargeable. However, the permanent
23 injunction remains enforceable notwithstanding the discharge and
24 may be enforced by the state court as it sees fit notwithstanding
25 Armstrong's bankruptcy. The court will enter a judgment to that
26 effect. Each side shall bear its own attorneys' fees and costs.

1 This memorandum constitutes the court's findings and
2 conclusions pursuant to FRCP 52(a) and FRBP 7052. Counsel for
3 Scientology shall submit an appropriate form of judgment forthwith.

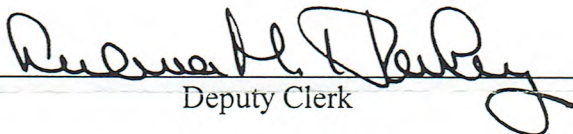
4 Dated: February 16, 1996


5 Alan Jaroslovsky
6 U.S. Bankruptcy Judge

CERTIFICATE OF MAILING

The undersigned deputy clerk of the United States Bankruptcy Court for the Northern District of California hereby certifies that a copy of the attached document was mailed to all parties listed below as required by the Bankruptcy Code and Rules of Bankruptcy Procedure.

Dated: February 16, 1996


Deputy Clerk

GERALD ARMSTRONG
715 Sir Francis Drake Boulevard
San Anselmo, CA 94960

WILSON, RYAN & CAMPILONGO
Andrew H. Wilson
Shauna T. Rajkowski
115 Sansome Street, Suite 400
San Francisco, CA 94104

MOXON & BARTILSON
Laurie J. Bartilson
6255 Sunset Boulevard, Suite 2000
Hollywood, CA 90028